

BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA

SHARON ANN WARREN,)	
)	
Appellant,)	DOCKET NO.: PT-2003-51
)	
THE DEPARTMENT OF REVENUE)	FACTUAL BACKGROUND,
OF THE STATE OF MONTANA,)	CONCLUSIONS OF LAW,
)	ORDER and OPPORTUNITY
Respondent.)	FOR JUDICIAL REVIEW

The above-entitled appeal was heard on September 28, 2004, in Bozeman, Montana, in accordance with an order of the State Tax Appeal Board of the State of Montana (Board). The notice of the hearing was duly given as required by law. The taxpayer, represented by her husband, Carl Warren, presented testimony in support of the appeal (taxpayer). The Department of Revenue (DOR), represented by Appraisers Lonnie Crawford and John Elliott, presented evidence and testimony in opposition to the appeal.

The duty of this Board is to determine the appropriate market value for the property based on a preponderance of the evidence. Testimony was taken from both the Taxpayer and the Department of Revenue, and exhibits from both parties were received. The Board allowed the record to

remain open for a period of time for the purpose of receiving post-hearing submissions.

The Board reverses the decision of the Gallatin County Tax Appeal Board.

FACTUAL BACKGROUND

1. Due, proper, and sufficient notice was given of this matter, the hearing hereon, and of the time and place of the hearing. All parties were afforded opportunity to present evidence, oral and documentary.
2. The subject property is residential in character and described as follows:

The improvements located on Lots 39, 40 and 41, Block 7, Fairview Addition, at 610 South Willson, City of Bozeman, County of Gallatin, State of Montana. (Geocode #: 06079907303330000, Assessor Code RGH1160).

3. For tax year 2003, the Department of Revenue appraised the subject property at \$49,880 for the land and \$568,050 for the improvements.
4. The taxpayer filed an appeal with the Gallatin County Tax Appeal Board on September 18, 2003, requesting a total property value of \$435,000, citing the following reasons for appeal:

Appraised value determined by “independent” appraisal from (Quality Appraisal Services) dated July 18, 2003. See attached appraisal report.

5. In its December 17, 2003 decision, the county board denied any reduction in value.
6. The taxpayer then appealed that decision to this Board on January 15, 2004, citing the following reason for appeal:
 1. The County Tax Appeal Board failed to consider the independent appraisal of the subject property presented to them at the hearing which utilized both a cost and sales approach to determine the value of the property to be at \$435,000.00
 2. The Department of Revenue's application of the Economic Condition Factor (ECF) to determine the market value of the improvements to the subject property was incorrectly calculated.

TAXPAYER'S CONTENTIONS

The taxpayers purchased the subject home in 1997, according to Mr. Warren, for \$266,500.

Mr. Warren presented Taxpayer's Exhibit 1, entitled "Bases for Appeal", in which he outlined the five issues on appeal:

1. Factual Errors and Mistakes

- a. Garage does NOT have a full kitchen. Area under question has built-in cabinets and a sink.
- b. Garage does NOT have a full-bathroom. It has a half-bath with a shower.
- c. Garage is NOT a 4-car garage, but a 2-car garage.
- d. House does NOT have 3 full-bathrooms. It has 1 full-bathroom (with bathtub) and 2 half-baths (with showers.)

2. Failure to Consider Effect of "Knob and Tube Wiring on Market Value.

The historic section of the house has "knob and tube" electrical wiring dating from the early 1900's. This has the effect of decreasing the market value of the house for two reasons.

- a. Potential buyers may not feel comfortable with "knob and tube" wiring since it is highly flammable if in poor condition.
- b. Potential buyers may NOT be able to obtain home insurance without replacing the "knob and tube" wiring. To replace "knob and tube" wiring would be costly. Our insurance company (USAA Insurance Company) will NOT issue new policies on homes with "knob and tube" wiring. When we initially purchased the property, USAA Insurance Company required a special inspection of the "knob and tube" wiring before agreeing to issue a homeowner's insurance policy. We are currently insured **only because** we are grandfathered in from when we initially purchased the property. The current insured value of the property (including garage) is \$484,000. The preceding statements were verified by telephone with USAA Insurance Company on September 27, 2004.

3. Failure to Consider Appraisals of Independent Certified Appraisers.

Two appraisals (included as Exhibits 2 and 3) have been conducted since July 1, 2003. These appraisals are summarized below:

- a. Quality Appraisal Service issued an appraisal report (Exhibit 2) dated July 18, 2003 that appraised the property using the sales comparison approach at \$435,000.
- b. Jorgenson Northwest Appraisal issued an appraisal report (Exhibit 3) dated April 7, 2004 that appraised the property using the sales comparison approach as \$560,000.

Note that the preceding appraisals were ordered by US Bank in support of loan applications. In both cases, US Bank selected and paid the appraisal firms.

4. Failure to Equalize Values of Area Under Montana Code Section 15-7-112.

Montana Code Section 15-7-112 states: "The same method of appraisal and assessment shall be used in each county of the state to the end that **comparable property** with similar true market values and subject to taxation in Montana shall have substantially **equal taxable values** at the end of each cyclical revaluation program hereinbefore provided. (emphasis added.)

We believe the following examples illustrate the failure to equalize values with the surrounding neighborhood where the property under appeal is located.

Example 1: 604 South Willson (Exhibit 4) is appraised at \$454,800.

- a. Same lot size and value
- b. 604 as 1,039 ft. more living area
- c. 3 fireplaces v. none for 604 S. Willson
- d. Both property have detached 2-car garages.

Example 2: Appraised values of other homes in surrounding neighborhoods (Exhibit 5)

600 block of South Willson (Exhibit 6)

- a. 603 appraised at \$279,700
- b. 604 appraised at \$454,800
- c. 607 appraised at \$262,000
- d. **610 appraised at \$617,930**
- e. 613 appraised at \$317,100
- f. 619 appraised at \$296,000
- g. 624 appraised at \$474,240

600 block of South Grand (Exhibit 7)

- a. 601 appraised at \$375,940
- b. 602 appraised at \$295,400
- c. 608 appraised at \$229,200
- d. 609 appraised at \$234,600
- e. 612 appraised at \$209,100
- f. 613 appraised at \$355,000
- g. 616 appraised at \$281,200
- h. 621 appraised at \$334,100
- i. 622 appraised at \$279,000

600 block of South Tracy (Exhibit 8)

- a. 601 appraised at \$357,200
- b. 607 appraised at \$263,300
- c. 611 appraised at \$178,600
- d. 615 appraised at \$255,500

Example 3: 601 South Grand is shown in advertisement (Exhibit 9) as being sold within the past 6 months for \$449,500. This property should be a good sales comparable for 610 South Willson.

Example 4: Per the MLS (Multiple Listing Service), 603 South Willson was listed as being sold for \$329,500 in May 2003. This property should be a good sales comparable for 610 South Willson.

Example 5: 521 South Willson is appraised at \$564,640 (Exhibit 10) has over 900 more sq. ft.

Example 6: 811 South Willson is appraised at \$792,040 (Exhibit 11) occupies an entire city block and has 11,253 sq. ft. (more than 8,500 more sq. ft.)

5. Failure to Support the Use of the 1.67 Economic Condition Factor.

The Montana Supreme Court in **Allbright v. St.** [281 M196, 933 P2d 815, 54 St.Rep. 132 (1997)] allows the use of the ECF (economic condition factor) in appraising property when comparable sales data are unavailable. However, in **Demarois v. DOR** and **Timmons v. DOR**, it has ruled that the Department of Revenue (DOR) must support the use of ECF including the data used to compute the ECF.

With respect to 610 S. Wilson, the DOR used an ECF of 1.67 to arrive at the appraised value of the property. However, DOR has failed to (1) show how 1.67 was determined or (b) what area (neighborhoods/properties) the 1.67 applied to during the assessment process.

The subject home, constructed in 1906, is in an historic Bozeman district. The taxpayers removed the original garage and built a new one that looked like a carriage house in keeping with the historic theme of the neighborhood. Mr. Warren was unable to provide an estimate of the cost to construct the new garage, but did estimate an amount in excess of \$300,000 for the construction of the new garage, an addition, and a remodel of the home. Mr. Warren disputes the DOR designation of the structure as a "four-car garage." He maintains it is not possible to fit four cars, or even three, in his garage, nor would the Bozeman Historic Preservation authorities permit such a structure to be built in the subject neighborhood.

Mr. Warren feels the presence of knob and tube wiring in the house dramatically affects its market value. This wiring system can be highly flammable and renders a home difficult, if not impossible, to insure. The subject home was only able to obtain insurance after passing an inspection and was "grandfathered in." Mr. Warren stated that his insurance company no longer insures homes with this type of wiring.

The kitchen area has been entirely renovated, including removal and replacement of the knob and tube wiring at a cost exceeding \$30,000, so they don't have a major appliance that's on knob and tube wiring. The cost to replace the remainder of this wiring in the house would be extremely prohibitive. Mr. Warren estimated it would cost between \$50,000 to \$100,000.

The DOR's failure to consider independent fee appraisals is a major issue of contention for the taxpayers. Using a cost approach to value, Quality Appraisal Service found a value of \$435,000 as of July 1, 2003. This appraisal was performed for the purpose of obtaining an equity line of credit. The DOR's appraisal found a total value of \$639,000. A second appraisal was

ordered when the taxpayers refinanced the original mortgage in 2004. As of April 7, 2004, Jorgenson Northwest appraisal found a value, using the sales comparison approach, of \$560,000.

As outlined above, the taxpayer feels the subject home has been appraised unfairly in comparison to similar properties.

Mr. Warren feels that the DOR failed to support its application of a 1.67 percent economic condition factor.

DOR'S CONTENTIONS

The DOR considers a dwelling to be something that has a kitchen that includes a hot water heater, a kitchen sink and cabinets. Whether or not the taxpayers decide to install a stove and refrigerator is up to them because the dwelling is wired for such installation. Therefore, the DOR does consider the garage improvements to be a dwelling for the above reasons and because it also has a bathroom.

The DOR counts the bathroom fixtures. They don't care whether it's a shower or a tub. Anything that has three fixtures is considered to be a full bathroom.

Regarding the four-car garage issue, the DOR does not actually state, on the property record card, that it's a

four-car garage. The DOR bases its cost and value on the number of square feet and the quality of construction present in a garage. If a garage has 200 square feet, it's considered a two-car garage and so on. The four-car designation is not an issue in regards to a value determination for the subject garage.

Regarding the presence of knob and tube wiring, the DOR referenced an article from a monthly publication of the *Bozeman Daily Chronicle* entitled "At Home." The March 2003 issue of this publication contained an article on the subject home. This home is in Bozeman's historic district. According to Ms. Crawford, any article in this publication speaks to "unique, upper-end homes", with a focus on craftsmanship, new technology of materials, and refurbishing of historical homes. "These are not your typical homes that are listed in this particular publication", according to Ms. Crawford. The March 2003 issue showcased the subject home. The article points out all the fine quality of craftsmanship inside the home as well as its historical significance, which undoubtedly adds to its value. Ms. Crawford stated that the article mentions that the knob and tube is fully functional.

Therefore, the DOR did not consider it to be a detriment because "they mentioned it right in the article" and did not take its presence into consideration in its appraisal. Ms. Crawford did acknowledge that the presence of knob and tube wiring would have a detrimental impact on a home's market value if that wiring rendered it unable to be insured. She stated that she just does not have proof of the insurability issue. She also stated that the DOR was not made aware of the taxpayers' concerns with this wiring until Mr. Warren brought the issue to the State Tax Appeal Board hearing.

The subject land was valued using comparable, verified, land sales. These sales were entered into a sales history database.

The improvement value was determined using the replacement cost new less depreciation method because good comparable sales were not available for improvements with two separate dwellings. The subject home also has a carriage house with living quarters above it (the garage property). This improvement is considered to be a separate dwelling, and thus was valued separately from the main residence.

An economic condition factor (ECF) 167% was applied to both structures. The ECF is a component within the cost approach to value. Summarized, Exhibit F states the following with respect to the ECF:

The final step in the cost approach is ensuring that estimated values are consistent with the market. This is extremely important since the cost approach includes individual estimates of value for land and buildings. The land values are estimated through the use of comparable sales. Building values are estimated through use of replacement cost less depreciation. However, replacement cost will only reflect the supply side of the market and therefore a market adjustment or economic condition factor is necessary to account for the demand side of the market.

The application of the Economic Condition Factor (ECF) or market adjustment is acknowledged by the International Association of Assessing Officers (IAAO) in their mass appraisal text, "Property Appraisal and Assessment Administration". Quoting from page 230 of the Summary, "Cost models, like other valuation models, should be specified and calibrated using local market information so that they reflect accurately the operation of local real estate markets.".(sic) And quoting from page 311 of the paragraph titled Market Adjustment Factors, "Market adjustment factors are often required to adjust values obtained from the cost approach to the market. These adjustments should be applied by type of property and area based on sales ratio studies or other market analyses. Accurate cost schedules, condition ratings, and depreciation schedules will minimize the need fro market adjustment factors." Further, the Montana Supreme Court upheld the use of Economic Condition Factors (ECF) by the Department in **Albright v. State of Montana**, 281 Mont. 196, 202-203, 933 P.2d 815, 819 (1997). A copy of that decision is attached to this definition.

The economic condition factor is a component for depreciation/appreciation or market adjustment that is uniformly applied across all properties in a given market area. Typically, economic condition factors will be at or below 100% for properties in economically depressed areas and greater than 100% in high growth areas.

The use of market adjustments is extremely important in the Montana Ad Valorem appraisal process. The Department of Revenue constructs a standardized depreciation table, using stabilized market and cost data.

The economic condition factor is used to correlate the cost approach to the market approach across the vastly different economic areas in Montana.

Because the economic condition factor is developed using a population of localized market data in a given area, it is unique to that market area and should never be adjusted on an individual basis.

The formula for calculation of the Economic Condition Factor (ECF) is as follows:

In each given market area, the ECF is the ratio determined by dividing the average market value by the average cost value, for those valid sales that were used in development of the market model for that market area.

Exhibit G is a document that further explains the ECF and also illustrates the method for calculating the ECF.

BOARD DISCUSSION

The taxpayer appealed the DOR's 2003 market value determination for the improvements to the Gallatin County Tax Appeal Board (GCTAB). GCTAB denied the taxpayer and subsequently, the taxpayer appealed to this Board.

The independent fee appraisals and the DOR's appraisal indicate the following values:

Taxpayer					
Exhibit	Date of Value	Land Value	Cost Approach Value (Improvements)	Sales Comparison Value	Final Value Indication
2	July 18, 2003	\$110,000	\$325,439	\$435,000	\$435,000
3	April 7, 2004	\$200,000	\$407,022	\$560,000	\$560,000
DOR					
B & C	January 1, 2003	\$49,880	\$568,050	NA	\$617,930

Based on the above value indications, it is clear the

appraisal of real property is an extremely subjective practice. The DOR testified that it could not provide a value by means of the sales comparison approach, because there was insufficient comparable data. The fee appraisals both employed the sales comparison approach in arriving at an indication of value.

The DOR established its value indication by means of the cost approach to value. The DOR testified, that as a component of the cost approach, it's necessary to adjust the value indication by the ECF. In this case, the DOR applied an ECF of 167%. The DOR points out that the ECF is an appropriate adjustment to the cost approach. In addition, the Supreme Court upheld its applicability in Albright v. State of Montana, 281 Mont. 196, 202-203, 933 P.2d 815, 819 (1997). Prior to the application of the ECF the DOR's cost approach would provide a value of \$340,150 for the improvements. Adding the value of the land, the total value is \$390,030. The application of an ECF of 167% would indicate that the area is thriving. No one suggested that the Bozeman area is not and was not experiencing rapid growth at the time of the DOR's date of value. However, the DOR did not provide this Board any supporting

documentation that would suggest that an ECF of 167% is appropriate for this property. The DOR has advocated values before this Board from the cost approach in previous appeals. This Board has no recollection of an ECF that was to the magnitude of 167% in past appeals statewide. Page three of DOR exhibit G, in summary states:

“After determination of ECF, it is necessary to update the ECF field (170) on each parcel in the market model area and associated parcels in the sales history file. To globally update Field 170, send copies of supporting documentation and selectability apply transactions requests to your Regional Manager. The Regional Manager will retain copies for their files and forward copies of supporting documentation and apply transaction requests to the Appraisal/Assessment Bureau for final approval and processing. Copies of attachments A, B, C, and requests for selectability apply transactions for each market model area will constitute appropriate documentation to retain...”

For the DOR to expect this Board to accept and uphold its value based upon the cost approach, the DOR should have been prepared to justify the 167% ECF with the documentation as noted above. Based upon what this Board knows about the 167% ECF it is capricious at best. It is true, as a general rule, that the Department of Revenue appraisal is presumed to be correct and that the taxpayer must overcome this presumption. The Department of Revenue should, however, bear a certain burden of providing documented evidence to support its assessed values. Western Airlines, Inc., v. Catherine Michunovich

et al., 149 Mont. 347, 428 P.2d 3, (1967).

The taxpayer provided this Board with an independent fee appraisal (Exh. 2) with a date of value of July 18, 2003. The appraiser arrived at a value of \$435,000 for the property. A second appraisal (Exh. 3) with a date of value of April 7, 2004 arrived at a value of \$560,000. The DOR's date of value is prior to both of those reports and based upon the DOR's value, it would suggest the market had been declining.

The Board notes that the subject property, based upon its characteristics, is unique, which could pose a challenge in appraising. This is evident based upon the wide range of values that have been presented.

The taxpayer asserts that the presence of the knob & tube wiring that is present in the property has an adverse impact to the overall value of the property. This may very well be the case, but the dollar amount must be extracted from the market. At this point, no credible evidence was presented to the Board to quantify an adjustment.

This Board must evaluate the evidence that it has been presented and issue an opinion of value based upon that evidence. It is the opinion of this Board that the best

indication of value for the property is \$435,000 as presented in exhibit 2.

CONCLUSIONS OF LAW

1. The State Tax Appeal Board has jurisdiction over this matter. §15-2-301, MCA.
2. §15-8-111 MCA. Assessment - market value standard - exceptions. (1) All taxable property must be assessed at 100% of its market value except as otherwise provided.
3. Western Airlines, Inc., v. Catherine Michunovich et al., 149 Mont. 347, 428 P.2d 3,(1967).
4. Albright V State of Montana, 281 Mont. 196, 1997
5. **15-7-111. Periodic revaluation of certain taxable property. (3) Beginning January 1, 2001, the department of revenue shall administer and supervise a program for the revaluation of all taxable property within classes three, four, and ten. A comprehensive written reappraisal plan must be promulgated by the department. The reappraisal plan adopted must provide that all class three, four, and ten property in each county is revalued by January 1, 2003, and each succeeding 6 years**

6. The appeal of the Taxpayer is hereby granted and the decision of the Gallatin County Tax Appeal Board is reversed.

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ORDER

IT IS THEREFORE ORDERED by the State Tax Appeal Board of the State of Montana that the subject property shall be entered on the tax rolls of Gallatin County by the local Department of Revenue office at the land value of \$110,000 for the land and \$325,000 for the improvements. The decision of the Gallatin County Tax Appeal Board is reversed.

Dated this 7th day of January 2005.

BY ORDER OF THE
STATE TAX APPEAL BOARD

(S E A L)

GREGORY A. THORNQUIST, Chairman

JERE ANN NELSON, Member

JOE R. ROBERTS, Member

NOTICE: You are entitled to judicial review of this Order in accordance with Section 15-2-303(2), MCA. Judicial review may be obtained by filing a petition in district court within 60 days following the service of this Order.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 7th day of January, 2005, the foregoing Order of the Board was served on the parties hereto by depositing a copy thereof in the U.S. Mails, postage prepaid, addressed to the parties as follows:

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